April 19, 2022
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Todd Asset Management

When Nothing Looks Good

Todd Asset Management Q1 2022 US Market Review and Commentary

	Q1 2022	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	-4.6%	15.7%	18.9%	16.0%	14.0%	14.6%
Russell 1000 Value	-0.7%	11.7%	13.0%	10.3%	9.7%	11.7%

* *Annualized Total Returns.*

To listen to strategists, nothing looks good. You name it, they're worried about it. War, higher rates, recession, inflation, yield curve inversions, supply chain problems, covid lockdowns… it seems consensus to say that nothing will go right ever again. That was the prevailing thought during a tough quarter for most asset classes in Q1. With the Fed beginning their long-anticipated tightening, some equity volatility is to be expected, and it probably lasts for a few months. In our collective experience though, when everyone knows what can go wrong it usually pays to ask what is going right and see what the market is telling you. What we hear the market telling us is that the Value rotation is real, and probably has years to go.

S&P Value minus S&P Growth 3/2002 to 4/2022

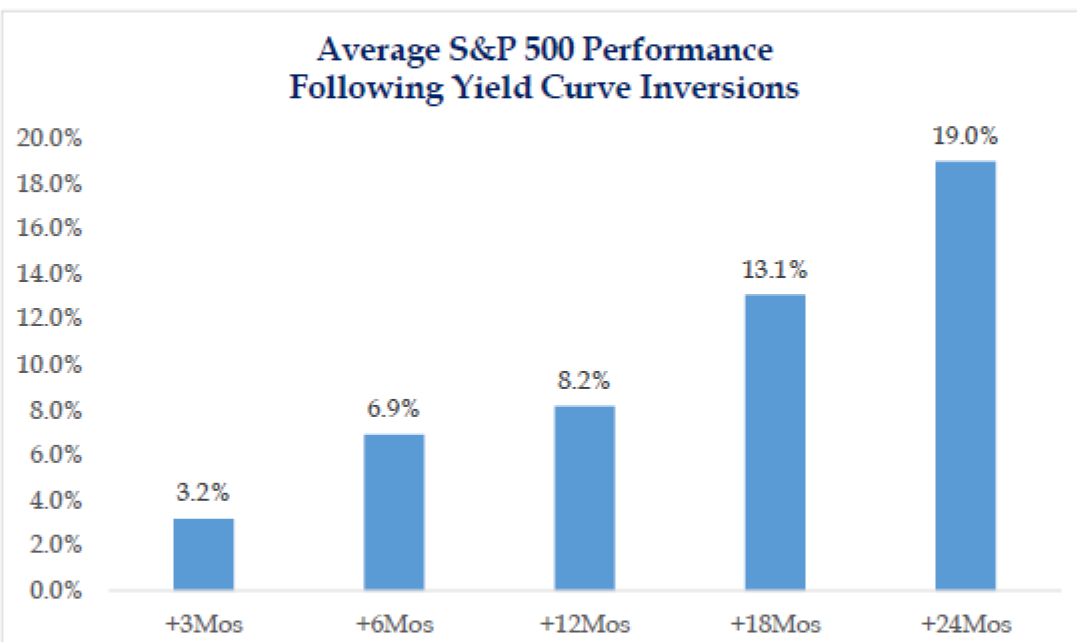
Source: Bloomberg as of 4-15-22

Points from the quarter:

- Higher rates prevailed as the 10-year increased from 1.51% at year end to over 2.8% in April and multiples contracted. Value led a declining market for the first time since the last Value cycle. High multiple stocks tend to underperform when rates increase. Regime changes are starting, with Value outperforming Growth and bond yields breaking a 40-year downtrend.

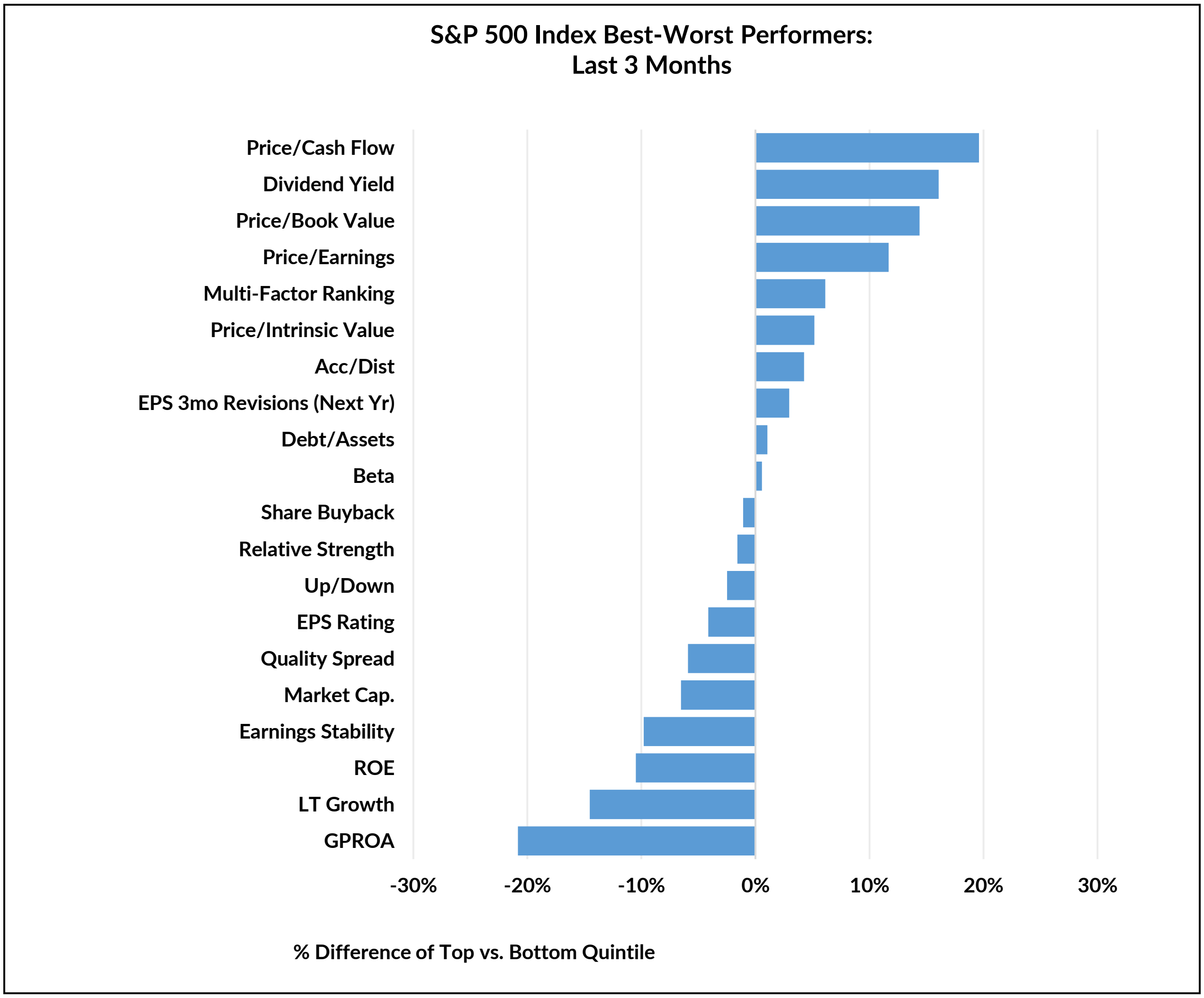
- Russia invaded the Ukraine, causing a disruption of energy and other commodities to world markets. Inflation, already high because of the covid related supply chain issues, spiked further to 40-year highs. Inflation may be peaking for the near term.
- The Fed began their long-anticipated tightening cycle and the yield curve briefly inverted. They appear far behind the curve as inflation is high. Most market participants believe the Fed will aggressively tighten until they break something. Consumer confidence has weakened.
- GDP estimates have been trimmed due to war uncertainty but are still robust. Unemployment is very low at 3.6%, wages are increasing, consumer and corporate debt remains low and real GDP growth is expected to be between 3 and 4% for 2022.

Market participants are moving more quickly and seem to be factoring in a recession faster than in previous cycles as the average stock in the S&P is already down over 20%. Midterm years are notoriously difficult, usually until late summer. Following that, they usually improve over the following year. Our sense is that while markets may remain wobbly for the first few rate hikes, this expansion still appears durable. The consumer has money in the bank, jobs, and a desire to get out after the Covid disruptions. Corporations have capital spending needs, clean balance sheets and pricing power. We are not saying there will not ever be a recession, just not right now in our estimation. Where could we be wrong? If the war in the Ukraine spreads, or energy exports are entirely curtailed from Russia, that could shock the economy into recession. Fed action probably will not induce a recession for some time to come. Markets typically rise following a yield curve inversion (see chart below from Strategas), as that normally coincides with a strong economy. Our guess is that after couple of months of volatility, they will do so this time as well.



Source: Strategas

Factors during Q1



Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

Our customary factor attribution for Q1 2022 is presented above. This chart measures the performance of the best 100 stocks versus the least attractive 100 stocks within the S&P 500 stock index, ranked by factor over the past quarter. Value factors performed very well during the quarter, as well as our multi-factor model. Quality and growth measures tended to underperform during the quarter, as investors dumped many growth issues that had previously been considered quality. This is different than trends seen over the past year, when value measures showed good performance but were accompanied by metrics showing good visibility of earnings and some quality. Technical indicators are weaker, as the former leadership is lagging. It often takes technical factors a quarter or two to catch up with the new leadership.

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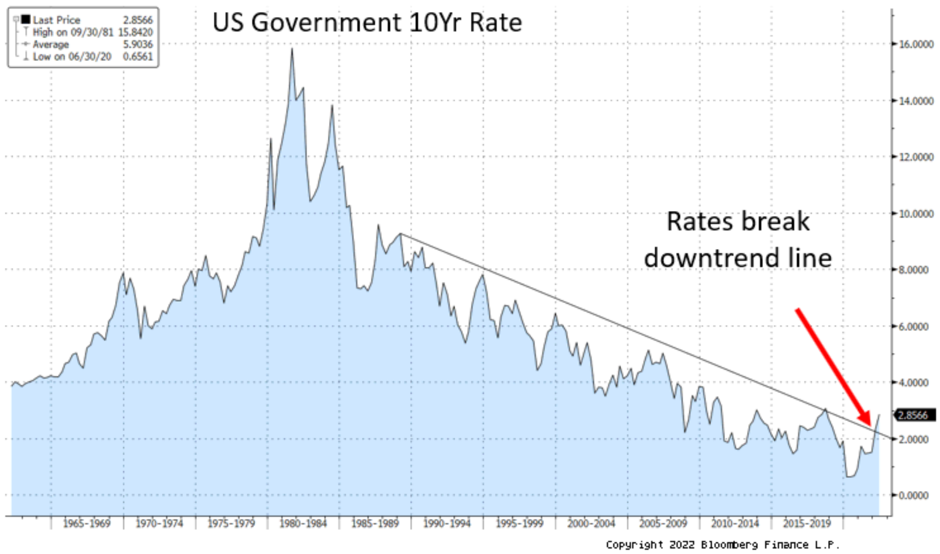
Charts We're Showing Our Clients:

Rates Broke a Long Downtrend



Yields on US 10 Year Bonds have been declining since 1981, the last time inflation was this high. The recent rise in rates has seen the 10 year break out of a downward pattern it has been in since 1987. This may reflect that the risk of inflation is higher than risk of deflation for now.

Markets Usually Recover Quickly after Conflicts

Markets usually recover quickly after conflicts. Since WWII, markets were up in 75% of instances one year post conflict. Three years post conflict, they were up 80% of the time.

Source: Bloomberg, MSCI, S&P and Todd Asset Management. Series is indexed to 100 on 12/30/1938. To show a longer time frame, the MSCI ACWI (Gross) was chained with the S&P 500 (Gross) to represent Global Equities. The ACWI is used from inception at 3/31/1988 since it includes both US and International Markets, and the S&P prior to that.

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Goods Driven Inflation May Be Peaking

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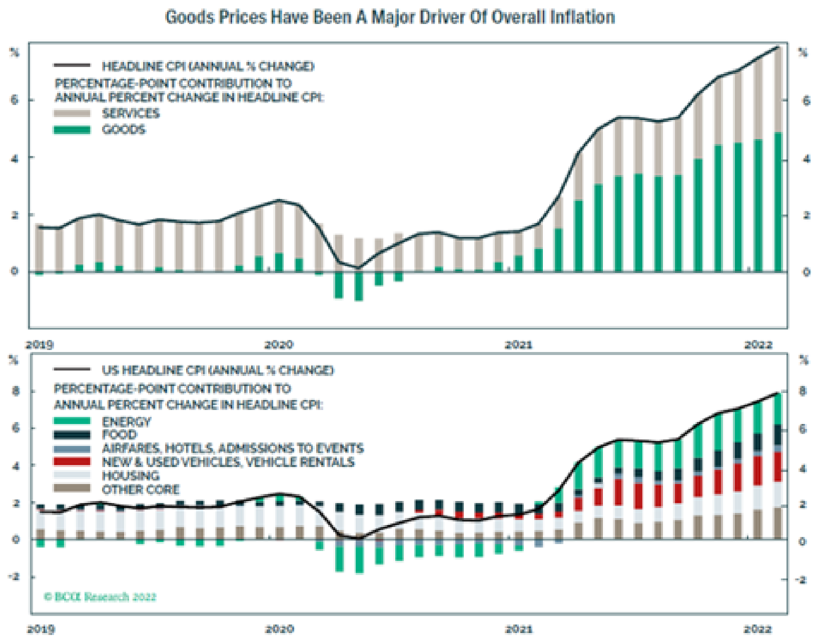

Source: BCA Research

Goods inflation has been the driver of overall CPI recently. We believe this should subside a bit when supply chains re-open.

Other inflationary pressures, notably wages and rents, are still building and may prove stickier. This could allow inflation to ease later this year and resume sometime next year.

Government Spending Remains High

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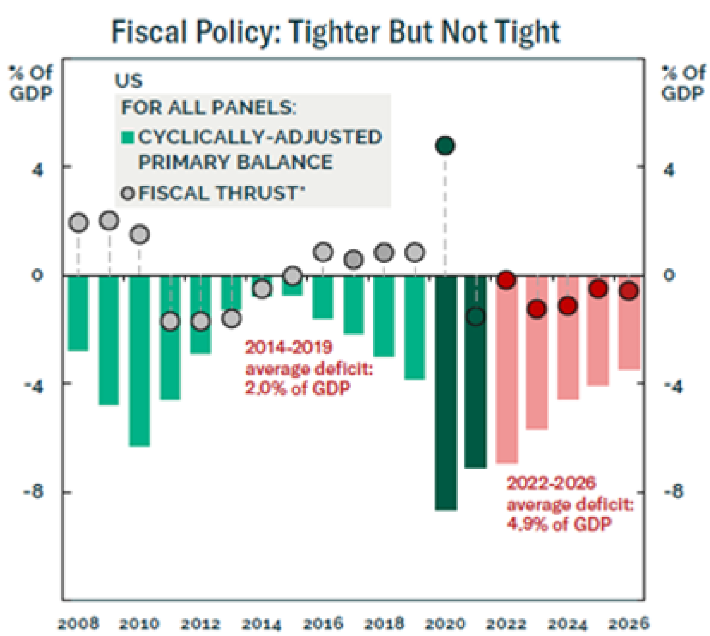


Source: BCA Research

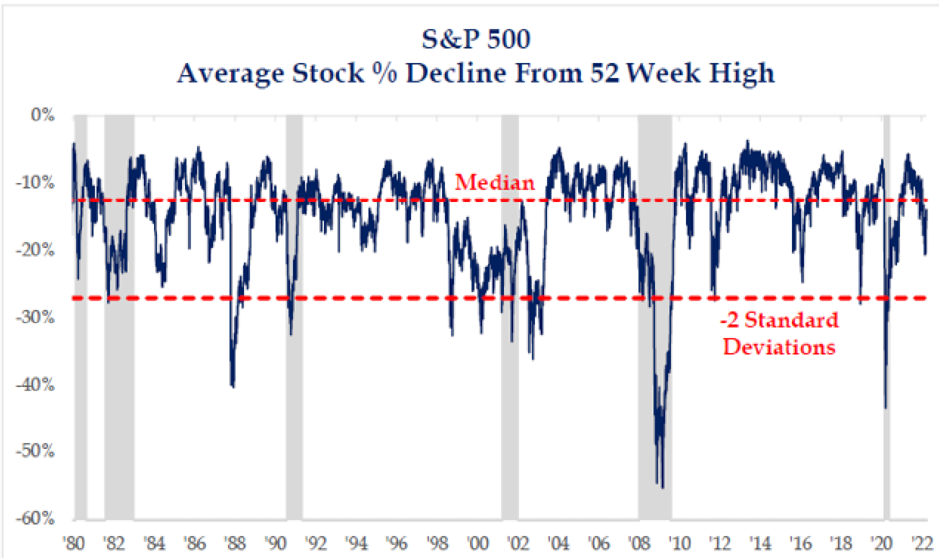
Government deficit spending should remain stimulative for the next several years. This stimulus is a major reason we believe the economy may not see a recession for some time to come.

Fiscal thrust, a measure of year over year change, is declining.

The Average Stock has Already Had A Bear Market

4/4/22

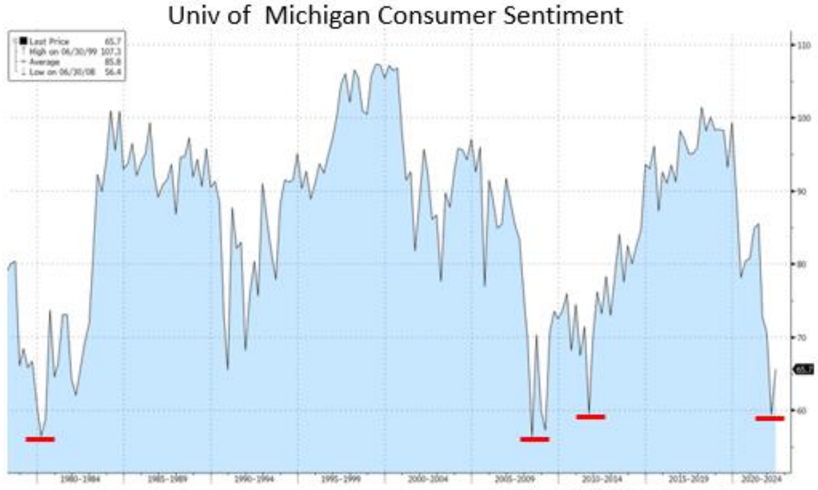
THE AVERAGE STOCK HAS ALREADY EXPERIENCED A BEAR MARKET DECLINING -20%



Source: Strategas

Sentiment Rebounding from Historic Lows

Univ of Michigan Consumer Sentiment



Sentiment is near lows reached in 1980, 2008 and 2011. The year following those lows, the S&P gained 25.2%, 17.9% and 25.3% respectively. Stay tuned.

Summary

Investors are worried about the headlines regarding war, inflation, potential recession and Fed tightening. These concerns all share the same concern: will the Fed have to raise rates to the point they snuff out the economy to snuff out inflation? We do not believe this is the case. If it becomes the case, it will still take a long time to achieve that. Investors have become very cautious this year as seen by sentiment indexes as well as the mixture of groups leading the market. Some of the leaders are clearly being bought for fear of a market pullback. Additionally, concerns are cropping up about mid-term elections and what they portend for future policy. We believe the lasting message investors should take from the recent market action is that there's a new regime in place. Rates have backed up, and likely need to go higher just to get to normal levels. Government spending is also at a higher plateau than over the past 10 years. If we can avoid the economy sliding into a recession, we believe this sets the stage for Value to continue its' recent recovery versus Growth. We are watching first quarter earnings closely to get a sense for what company managements think, and thus far we do not hear that a recession is imminent. If investors embrace that thought, we expect another leg up in the Value versus Growth trade.

As always, if you need any additional information, please feel free to contact any of us.

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04/19/22
S&P 500 – 4462
Russell 1000 Value – 1647

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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S&P 500 Index is a widely recognized index of market activity based on the aggregate performance of a selected portfolio of publicly traded common stocks. The performance data was supplied by Standard & Poor's. It is included to indicate the effect of general market conditions.

Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.